

# **The Role of One-time and Ongoing Expenditure Classification in Balancing Utah's Structural Deficit**

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**Report to the Executive Appropriations Committee  
Of the Utah State Legislature**

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## **Balancing Utah's Structural Deficit: Overview**

Utah's structural deficit – ongoing appropriations funded with one-time revenue sources – exceeds \$42 million for fiscal year 2004. While the structural deficit is covered by one-time revenue in FY 2004, new revenue must be identified if the appropriations are to continue in FY 2005. Conversely, each year appropriators could balance ongoing appropriations with ongoing revenue by providing one-time appropriations for projects and/or investments that are limited in scope and term. Doing so would reduce or eliminate the structural deficit, and signal policy makers' priorities for the following fiscal year.

This report examines Utah's structural deficit by asking the following questions:

1. What is a structural deficit?
2. What has been Utah's structural deficit for the past two years?
3. How are ongoing appropriations defined for the purposes of measuring structural deficit?
4. How could the State balance its structural deficit?
5. What are the pros and cons of providing one-time appropriations for capital investments?
6. To what extent could one-time funding of given capital programs balance Utah's structural deficit?

The report recommends that the Legislature consider balancing the state's structural deficit at the end of each appropriations session by providing one-time appropriations for discrete projects and programs such as capital investment.

### **What is a structural deficit?**

A structural deficit occurs when appropriations for ongoing programs exceed revenue from ongoing sources.<sup>1</sup> When an entity, such as a state, uses one-time revenue to cover ongoing costs, it incurs a structural deficit. While the entity's total budget may be in balance, it will have to address the structural deficit in the following fiscal year – when costs continue but revenues do not.

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<sup>1</sup> This definition of structural deficit assumes that ongoing appropriations accurately reflect ongoing needs to the extent that those needs are deemed legitimate by budget policy makers. Other definitions of structural deficit may include legitimate needs unmet by ongoing appropriations. Addressing such unmet needs would require additional ongoing revenue.

*Utah's ongoing appropriations are projected to exceed ongoing revenue by \$42 million in FY 2004*

For instance, for FY 2004, the Utah Legislature appropriated \$3,588,000,000 in state funds (General Fund, Uniform School Fund, and Income Tax Revenue) for ongoing programs. Ongoing revenue for FY 2004 (Sales and Use Tax, Income Tax, Corporate Franchise Tax, etc) was estimated at only \$3,546,000,000. The difference, \$42 million in this case, is a structural deficit.

Understanding structural deficits is important for at least two reasons. First, they limit the Legislature's options in subsequent fiscal years. Often, funding structural deficits is a Legislature's highest priority for the use of new ongoing revenue in the next fiscal year. This new revenue is therefore not available for growth or new initiatives.

*Structural deficits impact future funding flexibility and state bond ratings*

Second, financial rating agencies often include structural deficits in their consideration of a state's financial health and bond rating. The size of a state's structural deficit may influence its ability to repay investors in future years. If states must use new revenue to cover existing ongoing costs, such revenue will not be available for debt service. Rating agencies such as Standard and Poors, Fitch, and Moody's may consider downgrading a state's bond rating if the state's structural deficit is not brought into balance.

At the same time, states must adequately fund infrastructure maintenance, long-range infrastructure growth, and replacement plans to maintain a good bond rating. When balancing spending with revenue sources, careful consideration must be given to these long-term needs.

### **What has been Utah's structural deficit for the past two years?**

An entity's structural balance is fluid depending upon revenue collection. However, it can be measured at certain relevant points in time. The table below shows Utah's structural balance at the close of each annual General Session for fiscal years 2003 and 2004. The State's structural balance turned negative in FY 2002 due to more than \$685 million in ongoing revenue shortfalls between FY 2002 and FY 2003.

<b>State of Utah</b> <b>Structural Balance at Close of Annual General Session</b> <b>General Fund and School Funds in Thousands</b>		
	FY 2003	FY 2004
	Appropriated	Appropriated
Ongoing Revenue	\$3,520,355	\$3,545,762
Ongoing Appropriations	(\$3,592,265)	(\$3,587,962)
Structural Surplus/(Deficit)	(\$71,910)	(\$42,200)

*Transfers, one-time cuts, and special revenue cover structural deficits in a given year*

One-time revenue, such as transfers from restricted funds, sale of state assets, unappropriated revenue from the prior year, or one-time budget cuts usually finance this structural deficit in a given year.

For FY 2003, Legislators relied on transfers from other funds (tobacco settlement, building project reserves, Centennial Highway Fund) to finance the State's General Session structural deficit. The means by which Utah funded its structural deficit for FY 2004 are detailed below.<sup>2</sup>

<b>One-time Revenue Sources Used in the FY 2004 Budget</b> <b>State of Utah</b> <b>General and School Funds</b>	
<b>One-time Revenue Sources</b>	
Beginning Unappropriated Balance (FY03 Carry-forward)	35,648,200
Tobacco Settlement	9,821,500
Iron County Jail Sale	1,550,000
SITLA Payment	800,000
Commerce Service Fund Fines	2,000,000
Fire Academy Support Balance	1,000,000
Utah Technology Finance Corporation Liquidation	563,600
Risk Management Contributed Capital	425,000
Information Technology Services Internal Service Fund	452,000
Deoxyribonucleic Acid Specimen Account	189,500
<b>Subtotal</b>	<b>52,449,800</b>
<b>One-time Budget Cuts</b>	
Sale of State Building Lands	4,200,000
Tax Commission Nonlapsing	1,000,000
<b>Subtotal</b>	<b>5,200,000</b>
<b>Total One-time Sources (including budget cuts)</b>	<b>57,649,800</b>
One-time Appropriations	(13,460,200)
Ending Unappropriated Balance	(2,047,900)
<b>Structural Surplus/(Deficit)</b>	<b>(42,141,700)</b>

### **How are ongoing appropriations defined for the purposes of measuring structural deficit?**

As noted above, the structural deficit is determined by comparing ongoing revenue with ongoing appropriations. The definition of ongoing appropriations, therefore, is integral to the structural deficit.

<sup>2</sup> The structural deficit would have been further exacerbated had the Legislature not made nearly \$354 million in budget cuts to address repeated shortfalls in ongoing revenue.

*Ongoing appropriation status is sometimes independent of expenditure type*

Utah generally defines ongoing appropriations as all General Fund, Uniform School Fund, Income Tax, and Transportation Fund appropriations not designated as one-time in various appropriations acts. In some cases, ongoing appropriations are provided for ongoing expenditures like salaries, utilities, and health and human services benefit programs. In other cases, ongoing revenue covers multiple projects that are distinct and limited in scope and term, but meet continuing demands such as depreciation and growth.

For example, the Legislature may wish to provide funds for a new infrastructure program. However, the funds themselves may be used for individual projects like specific roads, buildings, or equipment, and therefore could be considered one-time expenditures. Appropriators may wish the funds to recur every year, and thus may designate them as ongoing.

In many instances, funds are provided for a mixture of continuing and discrete expenses, but are all appropriated as ongoing.

### **How could the State balance its structural deficit?**

Assuming a given level of economic production, policy makers generally have three alternatives for addressing structural deficits. The first alternative is to increase ongoing revenue through a general tax increase. The second is to reduce ongoing appropriations by cutting ongoing budgets. A third alternative, and the focus of this report, is to provide one-time appropriations for discrete projects currently contained in programs receiving ongoing appropriations.

*Appropriators could balance ongoing appropriations and ongoing revenue as they currently balance the General and School Funds*

At the end of each legislative session in which appropriations occur, the Executive Appropriations Committee (EAC) could balance ongoing appropriations with ongoing revenue by providing one-time appropriations for discrete infrastructure projects. This would be done so in a way similar to the way in which the EAC currently balances General Fund and Uniform School Fund appropriation with sales and income tax revenue, respectively. Such balancing would not only reduce or eliminate the structural balance, but would also signal funding priorities for the following fiscal year.

The Legislative Fiscal Analyst believes that at least some of Utah's ongoing appropriations cover one-time projects. While the demand for similar investments may recur from year to year, the Analyst considers individual capital investment projects to be limited in scope and term, and therefore compatible with one-time appropriation.

As such, this report presents four examples of capital programs through which policy makers could address the structural deficit. They are: the Capital Budget, the Centennial Highway Fund, the School Building Program, and across-the-board acquisition in categories of expenditure known as Capital Outlay and Data Processing Capital Outlay.

**Example One:  
Capital Budget**

The Capital Budget contains two major investment programs – Capital Development and Capital Improvements. Capital Development covers construction of new buildings and related infrastructure. Capital Improvements focuses upon discrete projects that maintain or prolong the life of State-owned buildings. In the past, both have been funded with ongoing appropriations.

*Capital Budget is one-time in nature, but receives ongoing appropriations*

Capital Development resources are used for a group of specific construction projects as determined by the Legislature and listed in various appropriations acts. The Capital Facilities and Administrative Services Appropriations Subcommittee of the Legislature goes to great lengths to avoid multi-year, or “phased” funding of any one project. While the nature of each individual capital development project is one-time, the funding for the program has been ongoing.

*Bonds – a one-time revenue source – are often used for Capital Development*

To balance the structural deficit, appropriators could provide one-time appropriations for some or all of the Capital Development program. In fact, the Legislature treated most of Capital Development as one-time for the FY 2003 and FY 2004 budgets by shifting its revenue source to bond proceeds.

Similarly, Capital Improvements funds are used for distinct capital maintenance projects as determined by the Division of Facilities Construction and Management. Funding for each is contained within a given year’s appropriation, even if the project itself spans multiple years.

As individual Capital Improvements projects are completed, they do not recur on an annual basis. Other projects may supplant them in a hierarchy of needs, but each investment decision is made independently and could therefore be seen as one-time in nature.

*By statute, Capital Improvements would receive priority over Capital Development for replacement funds in subsequent years*

Statute dictates that the Legislature provide Capital Improvements appropriations before it funds any new buildings. As such, if appropriations for Capital Improvements were one-time each year, and if the Legislature desired to build new buildings, Capital Improvements could be considered “mandates” for new one-time funds. This would make replacement one-time Capital Improvements appropriations one of the highest priorities for new funds in the annual Legislative budget process.

For FY 2004, the ongoing General Fund budget for Capital Development is \$1,870,000, and that for Capital Improvements is \$42,714,400.<sup>3</sup> Providing one-time appropriations for just part of these programs would balance Utah's \$42 million structural deficit.

**Example Two:  
Centennial Highway  
Fund**

The Centennial Highway Fund (CHF) was established to build, replace, and improve roads on Utah's State Transportation Infrastructure Plan (STIP). The program's budget includes General Funds, Transportation Funds, Federal Funds, and restricted funds. This example focuses upon the General Fund structural deficit, but the concept could be applied to the Transportation Fund as well.

General Fund contributions to the Centennial Highway Fund are provided to fund debt service as well as construction. The portion of the CHF used to repay debt is by its nature ongoing for the term of the bond. Lawmakers intend the remainder of the program to cover multiple road projects over a number of years, and thus made all General Fund appropriations for the Centennial Highway Fund ongoing.

*The construction  
portion of GF  
Centennial Highway  
Fund dollars could be  
one-time*

Assuming continuity with previous commitments, the Legislature could provide one-time appropriations for that portion of the Centennial Highway Fund dedicated to construction. Should they do so, the commitment they have demonstrated to the program in the past makes very high the likelihood that it would receive repeated annual one-time appropriations.

For fiscal years 2003 and 2004, the Legislature ultimately deferred state fund investment in CHF construction. In effect, appropriators treated CHF construction as one-time for FY 2002. By doing so, Legislators decreased the State's structural deficit by \$62 million. If ongoing construction appropriations are restored, they too would represent an opportunity to balance future structural deficits.

**Example Three:  
School Building  
Program**

Through the School Building Program, state tax payers assist local school districts with capital investments in schools and related facilities. The state funds supplement local property taxes, and are distributed based upon a statutory formula that includes a consideration for debt load. As the funds are dedicated for capital investment, they may also be compatible with one-time funding from the Uniform School Fund.

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<sup>3</sup> This amount is offset by \$4.2 one-time General Fund cut in FY 2004, making total resources for the program \$38.5 million in FY 2004.



Each district ultimately determines the extent to which funds are spent upon new projects or used to repay debt. Thus, each district would need to be examined independently should policy makers use the program to balance the structural deficit.

For FY 2004, the Uniform School Fund (USF) portion of the structural deficit is \$29.7 million, all of it related to a beginning unappropriated balance of about \$35 million carried forward from FY 2003. Policy makers could make up to \$27.8 million in funding for the School Building Program one-time to reduce the USF structural deficit. A different higher education appropriations mix for FY 2003, one that would change the GF/USF make-up of unappropriated ending balances, could eliminate the remainder of the USF structural deficit.

**Example Four:  
Across-the-board  
capital acquisition**

To a lesser extent, other agencies of state government make capital investments using ongoing resources. These capital acquisitions include vehicles, technology, equipment, and, in some cases, small buildings. This report refers to this type of acquisition as across-the-board capital acquisition.

*Reclassifying  
expensed capital  
acquisition should be  
considered on a case-  
by-case basis*

Utah State Government makes across-the-board capital acquisition in two ways. First, it purchases and pays for capital acquisitions in a single fiscal year. In this case, an agency may buy a computer or piece of equipment worth more than \$5,000, and pay for it in total with current year funds. For FY 2004, agencies budgeted an estimated \$622,000 in state funds for these “expensed” capital outlays.

In many cases, agencies use Federal or restricted funds to make capital acquisitions. Further, some capital investments may already be funded with one-time state revenue. As these and other factors complicate estimation of across-the-board capital acquisition, Legislators and staff would have to assess each program independently before reclassifying funds for capital investment as one-time.

*Reclassifying annual  
cost of depreciated  
capital is not  
practical*

Many agencies of state government acquire or replace assets using a second approach – Internal Service Funds (ISF). ISFs can purchase capital assets using borrowed money, and then depreciate the cost of the assets over a number of years.<sup>4</sup> For example, the hypothetical “ISF A” may purchase 100 capital assets at \$20,000 each for a total capital investment of \$2 million. The cost of the assets would be charged to user agencies over a period of seven years. The user agencies would use ongoing appropriations to reimburse “ISF A” \$285,700 (plus maintenance and administrative costs) per year.

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<sup>4</sup> Agencies must use existing resources to acquire additional vehicles through the Fleet Management Internal Service Fund. Fleet may use General Fund borrowing to acquire replacement vehicles.

In the above example, deferring the asset purchase would not eliminate agency reimbursements to “ISF A”. Agencies would continue to use existing, older assets, and continue to pay “ISF A”. If “ISF A’s” initial acquisition were funded by borrowing from the General Fund, the reimbursement would be required to repay that debt.

*Reimbursement of depreciated capital is an ongoing expense requiring ongoing appropriation*

As ISF capital acquisitions are not directly funded from state funds, deferral of this type of capital acquisition would not directly impact the structural deficit. Rather, agency reimbursements for this capital would impact the structural deficit. As such reimbursements are often required to depreciate past acquisitions, the Analyst views these reimbursements as ongoing.

For FY 2004, Utah’s internal service funds have new authority to acquire \$27 million in new capital assets. Depending upon the asset and the user agency, these costs would be amortized over three to seven years. They are also reimbursed from a blend of revenue sources. Given these complicating factors, the Analyst does not recommend providing one-time appropriations for reimbursement of ISF capital acquisition.

### **What are the pros and cons of providing one-time appropriations for capital investments?**

As with any public policy change, providing one-time appropriations for capital investments has associated benefits and costs. Its benefits include reduction of the structural deficit, more options for policy makers, better information on capital needs, and avoidance of potential base budget cuts. Its costs include decreased certainty of future year funding, potential impact on long-range planning, and risk of deferred capital investment.

#### **Pro: Reduction of the structural deficit**

Shifting appropriations for capital investments from ongoing to one-time reduces the state’s structural deficit. This, in turn, reflects positively in the State’s bond rating, as long as the State maintains a reasonable plan for infrastructure development and replacement.

#### **Pro: More options for policy makers**

As one-time funding for capital investment would not “automatically” recur each year, decreasing the structural deficit would allow appropriators more options when allocating new resources. Under Utah’s current process, “ongoing programs funded with one-time resources” usually receive top priority for new revenue. These “ongoing programs” are usually not discrete, but are amalgamated into the dollar amount of the structural deficit. Eliminating “ongoing programs funded with one-time needs”, and forcing annual competition of one-time capital investment gives decisions makers greater flexibility.

**Pro: Better information on capital needs**

Treating capital investment as a one-time appropriation provides decision makers better information on capital needs. Utah uses an incremental budget process by which, in general, “base budgets” are presumed to recur in the following fiscal year. Appropriators bear the burden of changing base budgets. Utah’s incremental budget system may give less scrutiny to ongoing appropriations.

One-time items, however, are treated in a manner similar to “zero-base” budgets. Each item is considered independently, and must compete against other items every year. Shifting the burden from appropriators to recipients will inevitably lead to better communication about capital needs.

**Pro: Avoidance of future budget cuts**

“Budget cuts” are typically defined as negative changes to a program’s base budget. If some capital investments are not part of the base, but must be reconsidered every year, then, in years with limited new resources, rather than “cutting” budgets, appropriators would authorize fewer one-time projects.

**Con: Decreased certainty of future year funding**

From a program proponent’s perspective, reclassifying any ongoing appropriation as one-time has one immediate impact – the following year’s funding is not “automatic”.

Providing one-time appropriations for capital investments shifts the burden from appropriators to recipients. Rather than merely defending a base budget, recipients must justify to Legislators the need for a given investment. That investment must then compete against all other incremental increases for available new resources. This, in-turn, marginally decreases the likelihood that a project will receive funding in consecutive years.

**Con: Potential impact on long-range planning**

Given that one-time funds are marginally less likely to recur in consecutive years, program managers may find long range planning more difficult. The perception alone of limited funds may lead managers to focus upon short-term goals, foregoing master plans. Inadequate funding of long-term plans can lead to more costly repairs and/or maintenance.

**Con: Risk of deferred maintenance**

As policy makers weigh competitors for new funding, they may deem capital investment easier to defer than health care or education. As such, they may choose to defer a given capital investment another year. Doing so may lead to increased costs associated with deferred maintenance, of which policy makers may or may not be aware.

In addition to structural deficit, long range planning and deferred maintenance are of concern to Bond rating agencies. Should appropriators decide to balance the structural deficit by providing one-time funding for capital investments, they must weigh the impact this may have upon the state's ability to meet long-term growth and replacement demands.

**To what extent could one-time funding of given capital programs balance Utah's structural deficit?**

The chart below illustrates how each example discussed above could have impacted Utah's structural deficit in Fiscal Years 2003 and 2004. Providing one-time appropriations for all of these programs could have positively impacted the State's structural deficit by an average of \$130 million per year over the past five years, and an estimated \$72 million in FY 2004.

<b>State of Utah</b> <b>Impact of Capital Investment Funding on Structural Balance</b> <b>General Fund and School Funds in Thousands</b>		
	FY 2003	FY 2004
	Appropriated	Appropriated
Ongoing Revenue	\$3,520,355	\$3,545,762
Ongoing Appropriations	(\$3,592,265)	(\$3,587,962)
Structural Surplus/(Deficit)	(\$71,910)	(\$42,200)
Capital Budget	\$73,511	\$44,585
Centennial Highway Fund	\$20,000	\$0
School Building Program	\$28,358	\$27,789
Expensed Across-the-board	\$622	\$622
Total Impact	\$122,491	\$72,996
Revised Structural Surplus/Deficit	\$50,581	\$30,796

**Recommendations**

The Legislative Fiscal Analyst suggests that the Legislature may want to consider balancing ongoing appropriations with ongoing revenue at the close of each appropriations session. Such balancing could be accomplished by providing one-time rather than ongoing appropriations for discrete projects such as capital investment, all the while analyzing the impact of such action on long-term needs. Budget staffs, both the Legislative Fiscal Analyst and Governor's Office of Planning and Budget, could prioritize funding for similar projects in the following year's competition for new one-time or ongoing revenue.